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Investing basics: 4 reasons not to hold too much cash

Cash has been king this year as savings balances swell and the economy wobbles, but it's not a great long-term proposition to reach your goals.

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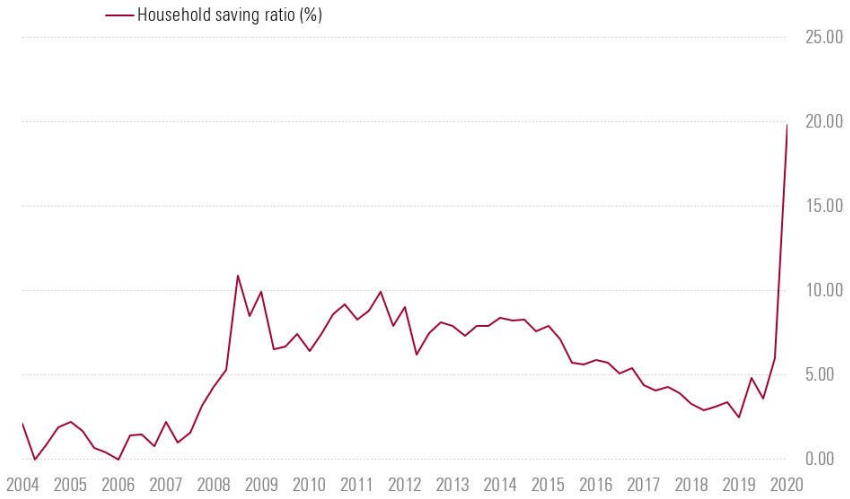
Mentioned: BetaShares Aus High Interest Cash ETF (AAA), Vanguard Australian Shares ETF (VAS), Vanguard MSCI Intl ETF (VGS)

Job uncertainty, no holidays, minimal commuting costs and closed shops are just some of the reasons why some savers built up big stockpiles of cash in 2020.

Data from the Australian Bureau of Statistics shows household savings rates skyrocketed in the second quarter of 2020 from 6 per cent to 19.8 per cent thanks to a record fall in consumption and an increase in social assistance benefits.

Household savings ratio, seasonally adjusted



Source: Australian Bureau of Statistics, Australian National Accounts: National Income, Expenditure and Product June 2020

While cash is comforting in a crisis, if you're fortunate enough to have saved money, here are four reasons not to leave this lingering in cash.

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1. Savings rates rarely beat inflation

The Reserve Bank of Australia cut interest rates to a record low of 0.10 per cent in November savings providers having been slashing rates across the board all year. That means that even with inflation under 1 per cent, you are still losing money in real terms.

According to Ratecity, more than 70 banks have cut savings rates since the November RBA rate cut. The best savings account pays 1.35 per cent while the average bank pays 0.42 per cent.

Saving account rates

	Bank	Account	Max rate
Highest conditional ongoing savings accounts	MyState Bank	Bonus Saver Account	1.35%
	ING	Savings Maximiser	1.35%
	UBank	USave with USpend	1.25%
Big four banks conditional savings rates	CBA	GoalSaver	0.50%
	Westpac	Life	0.55%
	NAB	Reward Saver	0.55%
	ANZ	Progress Saver	0.50%

Source: RateCity.com.au Conditions apply for max interest rate. Note rates are for balances over $50K. Excludes accounts specifically for younger Australians. At 11 December 2020.

2. Long-term performance

Many would-be investors feel more comfortable holding cash because they don't understand the stock market, or are reluctant to seek out advice. Countless studies show that equity (and bond) markets outperform cash over the long term – according to wealth manager and broker Charles Stanley, £10,000 invested in global markets in 2010 would now be worth approximately £30,742. The same amount held in a cash savings account would have grown to just £11,230.

"Many consumers are missing out on the opportunity to invest their money and make it work better for them in the longer term," the Financial Conduct Authority's latest report on the UK financial advice market. The FCA's latest research reveals that 37 per cent people with £10,000 of investable money have all of it cash, and 18 per cent have more than three-quarters of their wealth in cash.

Even with last year's economic and health crisis, many global stock markets finished the year higher than they started. The Vanguard Australian Shares ETF (ASX: VAS), for example, finished the year up 1.88 per cent. The Vanguard MSCI Intl ETF (ASX: VGS) was similarly up 5.78 per cent. That would have turned a $10,000 investment into $10,585 (total return). By comparison, that $10,000 in a high-interest cash ETF would have turned into $10,065.

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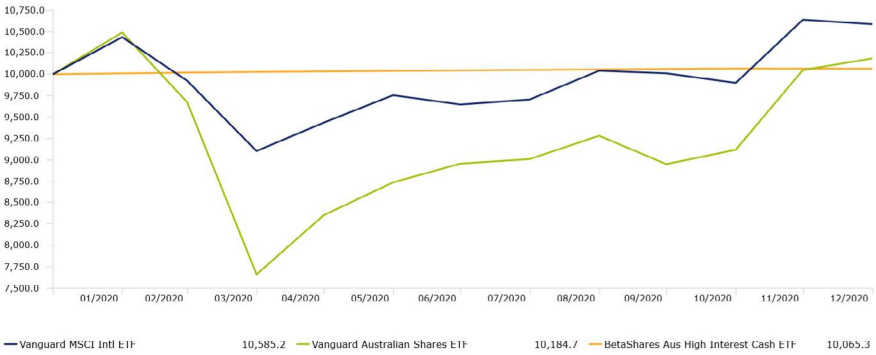
Of course, your attitude to that capital would have been very different in March 2020 when markets crashed.

Investment growth on $10k, 2020



Source: Morningstar Direct

3. The old rules are being ripped up

The Charles Stanley research is also revealing in that it shows how attitudes to cash and shares among the different generations. Asked why they had invested in the stock market, 42 per cent of 54-74 year olds replied that "returns on cash savings are poor", but only 12 per cent of 18-23 year olds gave that answer (28 per cent of millennials and 38 per cent of 39-53 year olds gave that as the reason).

People generally become more risk-averse the closer they get to retirement, needing less volatile (and more income-producing assets) as well as liquidity. But of the Baby Boomer age group, some 43 per cent said the main reason for investing was to save for retirement (compared with 11 per cent for the youngest age group).

Some 30 per cent of the 18-23 year olds said their equity investments were to buy a house; suggesting that younger people are prepared to take greater risks with their money to get on to the property ladder. You need cash for a house deposit, of course, but that money held in savings accounts will not grow very much even with compound interest.

4. Cash doesn't pay dividends

Australian investors face a dividend void in 2020, with blue chips ditching or deferring their dividends in an effort prioritise the survival of their businesses over distributing predictable cash payments to their shareholders. The ability to cancel or delay dividends offered boards an important source of funding to preserve the balance sheets or avoid a dilutive equity raising.

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Almost a quarter of the Australian companies under Morningstar coverage cut, cancelled, suspended or deferred their dividends since the coronavirus fallout hit markets in late-February. And it's not just within one industry. Dividend suspensions have been widespread.

The outlook for 2021 income investors is likely to be brighter than in 2020. APRA has announced that from 2021 the regulator will no longer require banks to limit distributions to 50 per cent of earnings.

"The long-term case for dividend payers remains strong," says strategist for Morningstar's Indexes group Dan Lefkovitz.

"Not only does a significant portion of the long-term total return from equities come from reinvested dividends and dividend growth, but dividend payers have posted a strong track record relative to non-payers and the overall market."

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